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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1937

No. 36

JOSEPH K. WILLING, Receiver of Commercial National Bank, Philadelphia, Pennsylvania,

Petitioner,

vs.

ISRAEL BINENSTOCK, Individually and as Surviving Partner of the Partnership Firm of Swinger and Binenstock, and BESSIE SWINGER, Individually and as Executrix of the Estate of Benjamin Swinger, Deceased,

Respondents.

BRIEF OF PETITIONER.

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INDEX.

Subject Index.

	Page
Opinions below	1
Jurisdiction	2
Statement of the case	2
Specification of errors	5
Summary of argument	5
Argument:	
I. In deciding questions of set-off as applied to insolvent National Banks the Courts are bound by the established rules of the Federal Courts and should not follow the widely varying irreconcilable and conflicting rules of set-off prevailing in the several states	7
(a) Preliminary statement	7
(b) Set-off as applied to insolvent National Banks is a matter of substance, not procedure, whether at law or in equity	8
(c) Every matter (including set-off) relating to the distribution of assets of an insolvent National Bank presents a question arising under the winding up provisions of the National Bank Act	10
(d) In deciding controversies involving set-off as applied to insolvent National Banks Federal Courts will not follow the varying rules of State Courts (applicable to insolvents generally) but rather will exercise an independent judgment in order that there may be a uniformity throughout the several states	12
(e) Not governed by the Conformity Act	14
II. Joint primary obligations of a partnership due to an insolvent National Bank cannot be set off against the individual deposit accounts of the several partners	15
(a) General rules of set-off stated	15
(b) The debt of the partnership to the bank and the individual deposit accounts of the Respondents are lacking in mutuality, therefore are not subject to set-off	16
(c) Equity will not permit set-off of non-mutual debts unless there are equitable grounds other than insolvency	18
III. The endorsement liability of the partnership cannot be set off against the individual deposit accounts of the Respondents	25
IV. Authorities cited by courts below and Respondents, distinguished	27

Page

(a) On question of whether Federal Court or State Court rule should be followed 27
(b) Set-off cases cited by court below, distinguished 30
V. Other set-off cases discussed and distinguished 34
Conclusion 40
Appendix 42

TABLE OF CASES CITED.

Bank of United States v. Braveman, 259 N. Y. 65, 181 N. E. 50 25
Barnett v. Muncie National Bank, 98 U. S. 555 14
Barrington v. Maner, 54 Fed. (2d) 917 ..... 19, 37
Beauregard v. Case, 91 U. S. 134 ..... 15, 20, 34, 35
Black and White Taxicab and Transfer Company v. Brown and Yellow Taxicab and Transfer Company, 276 U. S. 518 28
Bromfield v. Trinidad National Investment Company (C. C. A. 10), 36 Fed. (2d) 646 20
Bromley-Shepard Company, Inc., et al., v. Roelker (D. C. Mass.), 8 Fed. Supp. 214, affirmed Roelker v. Bromley-Shepard Co., Inc., et al., 73 Fed. (2d) 618, cert. den. 294 U. S. 713 ..... 10, 20, 33, 34
Bryant Brothers v. Wilson, 253 Ky. 578, 69 S. W. (2d) 1020 24
Bryant v. Williams (D. C. N. C.), 16 Fed. (2d) 159 25
Building and Engineering Company v. Northern Bank (N. Y.), 99 N. E. 1044 19
Burgess v. Seligman, 107 U. S. 20 27
Case v. Terrell, 11 Wall. 199 22
Champlin Refining Company v. The Gasoline Products Co., 29 Fed. (2d) 331 9
Connecticut Mutual Life Insurance Co. v. Schaefer, 94 U. S. 457 29
Cook County National Bank v. United States, 107 U. S. 445 ..... 9, 18
Dakin v. Bayly, 290 U. S. 143, 90 A. L. R. 999 ..... 14, 15, 18
Drexel v. Berney, 122 U. S. 241 15
Fidelity and Deposit Co., v. Duke (C. C. A. 9), 293 Fed. 661 19
Fiman v. State of South Dakota (C. C. A. 8), 20 Fed. (2d) 776, Cert. Den. 279 U. S. 841 14
First National Bank of Indianola v. Malone (C. C. A. 8), 76 Fed. (2d) 251 ..... 10, 39
First National Bank v. Selden (C. C. A. 7), 120 Fed. 212 13
Froess v. Froess, 284 Pa. 369, 131 Atl. 276 17
Gray v. Rollo, 18 Wall. (85 U. S.) 629 ..... 7, 12, 14, 15, 32, 33
Gray v. School District (C. C. A. 3), 67 Fed. (2d) 141, Cert. Den., Hustead v. School District, 291 U. S. 660 ..... 19, 20, 23
Groves v. Sentell, 153 U. S. 465 16
Hanover National Bank v. Suddath, 215 U. S. 122 23
In Re Garfunkel, 8 Fed. (2d) 790 25
In Re Schults, et al. (D. C. N. Y.), 132 Fed. 573 40
Jewett v. Martinsville Milling Company (C. C. A. 7), 76 Fed. (2d) 153 ..... 20, 22, 23

Page

Kennedy v. Gibson, 8 Wall. 498 22
Kingdom of Norway v. Federal Sugar Refining Company (D. C. N. Y.), 286 Fed. 188 ..... 8, 9
Kirby v. Lake Shore and Michigan Railroad, 120 U. S. 130 29
Knaffle v. Knoxville Banking & Trust Co. (Tenn.), 159 S. W. 838, 50 L. R. A. (N. S.) 167 ..... 19, 25
Luckenbach Steamship Company v. Norwegian Barque Thekla, 266 U. S. 328 8
McCandless v. Dyar (D. C. S. D.), 34 Fed. (2d) 989 13
McCandless v. Furlaud, 296 U. S. 140, rehearing denied, 296 U. S. 664 22
Millett v. Omaha National Bank (C. C. A. 8), 30 Fed. (2d) 665 20
Murrill v. Neill, 8 How. 414 17
Norfolk Southern Railroad Co., v. Ferebee, 238 U. S. 269 15
Planters National Bank v. Wysong and Miles Co., et al., 177 N. C. 380, 99 S. E. 199, 12 A. L. R. 1412, Cert. Den. 250 U. S. 665, and error dismissed, 251 U. S. 665 14
Powell v. Mobley (Ga.), 142 S. E. 678 30
Richmond v. Litteer (C. C. A. 8), 1 Fed. (2d) 311 20
Sawyer v. Hoag, 17 Wall. 610 ..... 15, 19
Scammon v. Kimball, Assignee, 92 U. S. 362 15
Scott v. Armstrong, 146 U. S. 499 ..... 10, 11, 14, 19, 20, 22, 35, 36
Shannon v. Sutherland (C. C. A. 4), 74 Fed. (2d) 530 ..... 9, 20, 23, 25, 37, 38, 39
Sim v. Edenborn, 242 U. S. 131 27
Southern Railway Company v. Elliott, et al. (C. C. A. 4), 86 Fed. (2d) 294 18
Spurway v. Weintraub, 66 Fed. (2d) 69 25
Swift v. Tyson, 16 Pet. 1 28
Texas and Pacific Railway Company v. Pottorff, 291 U. S. 245 22
Thomas v. Potter Title and Trust Company (D. C. Pa.), 2 Fed. Supp. 12 ..... 14, 18
Trainor Company v. Aetna Casualty Company, 290 U. S. 47 28
Tucker v. Oxley, 5 Cranch. 34 ..... 30, 32
United States v. Beaty (D. C. Va.), 198 Fed. 284, reversed on other grounds, 208 Fed. 620; case certified to Supreme Court, 211 Fed. 1019; writ of error dismissed, 232 U. S. 463 15
United States v. Eckford, 6 Wall. 484 8
United States v. Rathbone, Fed. Cas. No. 16,121 29
Williams v. Heard, 140 U. S. 529 11
Williams v. Rose, 218 Fed. 898 25
Williams v. Thomas (D. C. Mich.), 6 Fed. Supp. 1011 ..... 23, 26
Wisdom v. Guess Dry Cleaning Company (D. C. Miss.), 5 Fed. Supp. 762 ..... 10, 37
Wolcott v. Pierre, 100 Ind. App. 16, 188 N. E. 596 ..... 21, 30
Yardley v. Clothier (C. C. A. 3), 51 Fed. 506, 17 L. R. A. 462 19

TEXT CITED.

44 Yale Law Journal 171 24

Table of Statutes Cited.

	Page
National Bank Act:	
Title 12, Sec. 91, U. S. Code, quoted in full in appendix, page 42	11, 12, 23
Title 12, Sec. 192, U. S. Code, quoted in part in appendix, page 42	11
Title 12, Sec. 194, U. S. Code, quoted in full in appendix, page 43	11, 23
Pennsylvania Partnership Statutes:	
Purdon's Pennsylvania Statutes Annotated, Sec. 37, quoted in part	16
Purdon's Pennsylvania Statutes Annotated, Sec. 102, quoted in part in appendix, page 43	17
Other Statutes Cited and Discussed:	
Title 28, Sec. 724, U. S. Code, quoted in full in appendix, page 44	14
Title 28, Sec. 725, U. S. Code, quoted in full at page	28
Title 28, Sec. 347(a)	2
Title 31, Sec. 191, U. S. Code, quoted in full in appendix at page 44	9

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JOSEPH K. WILLING, RECEIVER OF COMMERCIAL NATIONAL BANK, PHILADELPHIA, PENNSYLVANIA,

Petitioner,

vs.

ISRAEL BINENSTOCK, INDIVIDUALLY AND AS SURVIVING PARTNER OF THE PARTNERSHIP FIRM OF SWINGER AND BINENSTOCK, AND BESSIE SWINGER, INDIVIDUALLY AND AS EXECUTRIX OF THE ESTATE OF BENJAMIN SWINGER, DECEASED,

Respondents.

BRIEF OF PETITIONER.

Opinions Below.

The opinion of the United States District Court for the Eastern District of Pennsylvania (Kirkpatrick, D. J.) appears at pages 8 to 11, inclusive, of the Record, and is reported in 18 Fed. Supp. at 262.

The *per curiam* opinion of the United States Circuit Court of Appeals for the Third Circuit affirming the decision of the District Court appears at pages 18 and 19 of the Record and is reported in 88 F. (2d) at 474.

Jurisdiction.

The judgment of the United States Circuit Court of Appeals for the Third Circuit was entered on February 2, 1937 (R. 19). Petition for writ of certiorari was filed on April 28, 1937 (R. 20), under Section 240(a) of the Judicial Code as amended by the Act of February 13, 1925, c. 229, Sec. 1, 43 Stat. 938 (U. S. C. Title 28, Sec. 347(a)), and the order allowing the writ of certiorari was filed May 24, 1937 (R. 20).

Statement of the Case.

Respondents (Israel Binenstock, individually, and as surviving partner of the partnership firm of Swinger and Binenstock, and Bessie Swinger, individually, and as executrix of the Estate of Benjamin Swinger, deceased), filed a bill in equity on July 12, 1935, in the United States District Court for the Eastern District of Pennsylvania against petitioner, as receiver (R. 2-6), wherein the respondents prayed for a decree directing the petitioner to set off the indebtedness of the partnership to the bank (both as maker and as endorser) against (1) the individual deposit account of Benjamin Swinger; and (2) so much of the individual deposit account of Israel Binenstock as may be necessary to cancel the remainder of said firm indebtedness.

The essential and undisputed facts are:

On March 1, 1933, but as of the close of business on February 28, 1933, the Commercial National Bank of Philadelphia, Pennsylvania, (referred to hereinafter as the bank) failed (R. 2, 12) whereupon the Comptroller of the Currency assumed control of its business and assets (R. 2, 12). At the close of business on February 28, 1933, Benjamin Swinger and Israel Binenstock, partners doing business under the firm name of Swinger and Binenstock were indebted to the said bank on the following described obligations, previously incurred, which were among the assets of the said bank as of the date of its failure:

Two joint notes for $10,000 each, executed and delivered to the bank by the firm (R. 3, 5, 12)	$20,000.00
One joint note for $2,604.10 executed and delivered to the bank by the firm to guarantee certain indebtedness of Salz Grocery Company, which note had been reduced by payments made up to the date of the filing of this suit to a balance of (R. 3, 6, 12)	37.98
One note, payable March 25, 1933, executed and delivered by Luciano Cammarota, as maker, to the firm which note was subsequently endorsed by the firm and discounted by the bank (R. 3, 6, 12) in the principal sum of	300.00

Benjamin Swinger, one of the members of the firm, died on February 28, 1933 (R. 2, 13). Thereafter, the partnership business of the said firm was conducted by Israel Binenstock, the surviving partner, and Bessie Swinger, the widow and the sole beneficiary and executrix of the estate of Benjamin Swinger, deceased (R. 2, 13).

At the close of business on February 28, 1933, the following deposit accounts were among the liabilities of the said bank:

Swinger and Binenstock, $5,822.52; Benjamin Swinger, $1,546.58; Israel Binenstock, $32,323.76 (R. 3, 12).

Petitioner credited one of the firm notes aforesaid with the sum of $5,822.52 by way of set off, *i. e.*, the balance of the firm's deposit account as of February 28, 1933 (R. 3, 12).

The questions presented to the District Court were:

(1) Whether the *individual* deposit balances of the members of the firm can be properly set off against the *primary joint obligations* of the firm to the insolvent national bank; and (2) whether the *individual* deposit balances of the members of the partnership can be properly set off against the

joint endorsement liability of the firm to the insolvent national bank.

Petitioner contended that the rules of the Federal Courts govern the right of set-off as applied to insolvent national banks and that, under the Federal rules, separate deposit accounts of individual partners cannot be set off against joint obligations of the partnership due and owing to an insolvent national bank.

The District Court denied petitioner's motion to dismiss (R. 11) and after hearing on bill (R. 2-6), answer (R. 11, 12) and stipulation (R. 13), entered its decree ordering and directing that petitioner set off the primary obligations of the firm totalling the principal sum of $20,037.98 as well as the secondary obligation of the firm, as endorser, on the $300 Cammarota note against (1) the $5,822.52 deposit balance belonging to the firm; (2) the $1,546.58 deposit balance of Benjamin Swinger, deceased, and (3) $12,968.88 of the deposit balance of Israel Binenstock, thereby cancelling all indebtedness of the firm to the bank (R. 13, 14).

The District Court also ordered petitioner to allow a claim in favor of respondent Binenstock in the amount of $19,-354.88 being the remainder of his deposit account after making provision for the set-offs as directed (R. 13). Petitioner was further directed by the District Court to endorse without recourse and deliver to respondent Binenstock the aforesaid $300 Cammarota note (R. 13).

The Circuit Court of Appeals (in a per curiam opinion), affirmed the decision of the District Court (R. 18, 19). The basis of the decision of both courts below was that "Since the question is balanced with doubt," the law of the State of Pennsylvania should be followed by the Federal Court sitting in Pennsylvania "for the sake of harmony and to avoid confusion."

Petitioner contends: (1) that the questions here presented are not balanced with doubt; (2) that whether or not such

questions are balanced with doubt, they are to be controlled by the uniform Federal rules relating to set off which are applicable to insolvent national banks (as distinguished from the variable and irreconcilable rules of the several states); (3) that under the Federal rule separate claims of individual partners cannot be set off against partnership (joint) obligations to an insolvent national bank; (4) that under the Federal rule separate claims of individual partners cannot be set off against the joint endorsement liability of the partnership to an insolvent national bank.

Specification of Errors.

It is submitted that the Circuit Court of Appeals for the Third Circuit erred:

1. In allowing respondents (partners) to set off their respective individual deposit accounts in the insolvent national bank against the joint primary obligations of the partnership to the bank.
2. In allowing respondents (partners) to set off their respective individual deposit accounts in the insolvent national bank against the joint secondary liability (as endorsers) of the partnership to the bank.
3. In deciding that the right of individual members of a partnership to set off their individual deposit accounts in an insolvent national bank against their joint obligations (both as makers and endorsers) to such bank is a question balanced with doubt.
4. In deciding that the law of set-off as applied to insolvent national banks is governed by the State rule.
5. In not dismissing respondents' bill in equity.

Summary of Argument.

Set-off as applied to insolvent national banks is (1) a matter of substance, not procedure, and (2) a matter of general law.

The National Bank Act constitutes a complete code for winding up national banking associations and must be construed uniformly throughout the several States. Federal courts exercise an independent judgment on matters of set-off as applied to insolvent national banks and do not follow the varying rules of State courts as applied to other insolvents.

Primary joint obligations of a partnership due to an insolvent national bank cannot be set off against the separate demands of the individual partners because (1) the demands are not mutual; (2) the requirement of mutuality of parties is lacking; (3) there is no mutuality of right; (4) there is no mutuality in quality of right; (5) to permit the set-off would violate the illegal preference and ratable distribution provisions of the National Bank Act.

Insolvency of the bank, while a ground for equitable intervention is not a sufficient equity standing by itself to defeat the requirements of mutuality, because that equity favors not only the respondents but also every other depositor of the bank as well.

There are numerous equities favorable to all depositors and creditors which are superior to the single equity (aforementioned) of respondents as partners.

Individual deposit accounts of members of a partnership cannot be set off against the joint liability of the firm as endorser on the note of a third party, because

(1) Mutuality of obligation, mutuality of parties, mutuality of right and mutuality of quality of right are lacking.

(2) It would cause the individual partners to be preferred over other depositors and creditors of the bank in violation of the National Bank Act.

ARGUMENT.

I.

In Deciding Questions of Set-Off as Applied to Insolvent National Banks the Courts are Bound by the Established Rules of the Federal Courts and Should Not Follow the Widely Varying Irreconcilable and Conflicting Rules of Set-Off Prevailing in the Several States.

(a) *Preliminary Statement.*

The courts below held (erroneously we submit) and the respondents' chief contention is that the Pennsylvania rule should be followed and set-off allowed in this case "since the question seems to be balanced with doubt" (R. 9) and since "the dictum in *Gray* v. *Rollo*, 85 U. S., 629, is to the effect that it (*set-off*) would be (*allowable*)." (R. 11.) (Italics inserted.) It is respectfully submitted that the above conclusions are the fundamental errors from which flowed the inequitable results of and other errors in the decisions below.

We shall endeavor to show under the headings and subheadings which follow (1) that set-off as applied to insolvent national banks is a matter of substance, and (2) that all courts, Federal and State, are bound by the Federal rules governing set-off as a matter of substance, and as a matter of general law, and (3) that the rules of set-off applicable to the facts here presented have been settled by this and other Federal courts, and (4) that the applicable Federal rules and statutes prohibit the set-offs here sought by respondents.

We will then show that the facts involved in the cases relied upon by the respondents and the courts below are clearly distinguishable from the facts here presented.

(b) *Set-off as Applied to Insolvent National Banks is a Matter of Substance, Not Procedure, Whether at Law or in Equity.*

The right of set-off, non-existent at common law, was introduced and provided for by statute of 2 Geo. II, c. 24, Section 4, made permanent by the statute of 8 Geo. II, c. 24, Sections 4 and 5 which enacted that where mutual debts exist between the plaintiff and defendant, one debt may be set off against the other in order to avoid circuity of action and injustice.

United States v. *Eckford,* 6 Wall. 484, 488.

While set-off was introduced as a part of our procedural law it is rapidly becoming recognized generally as a requirement of substantive law. Circuit Judge Mack briefly reviewed the historical development of set-off in—

Kingdom of Norway v. *Federal Sugar Refining Company* (D. C. N. Y.), 286 Fed. 188, 192-3,

and permitted set-off to be pleaded in an action at law brought by the sovereign State of Norway (even though that kingdom was immune from suit without its consent), on the theory that set-off is a matter of substance rather than procedure.

In form the trial of collision cases in admiralty is upon libel and cross-libel but the real issue is whether the vessel libeled or the vessel cross-libeled is at fault. This rule applies even though the United States is the party against whom the cross-libel is filed.

Luckenbach Steamship Company v. *Norwegian Barque Thekla,* 266 U. S. 328, 340.

The United Sates Circuit Court of Appeals for the First Circuit held that the District Court erred in striking the defendants' plea of set-off for damages (even though not technically calculable in accordance with the Maine statute of set-off) in a suit brought in Maine by a New York

firm against an Oklahoma concern in the case of *Champlin Refining Company* v. *The Gasoline Products Company*, 29 F. (2d) 331, and in so doing recognized (at page 338) the general doctrine as stated by Circuit Judge Mack in *Kingdom of Norway* v. *Federal Sugar Refining Co.* (referred to by the Circuit Court of Appeals for the First Circuit as "The Gloria"), *supra*, that set-off "has now become really a requirement of substantive justice."

Little more than a decade after the National Bank Act became effective this Court in *Cook County National Bank* v. *United States*, 107 U. S. 445, reviewed and reversed the decree of the lower court overruling a demurrer filed by the defendant, a national bank receiver, to a bill filed by the Federal government wherein the latter relying upon the provisions of 3466 U. S. R. S. (quoted in appendix, page 44), (giving the United States a prior or preferential right over other creditors of insolvent persons and estates), asserted that it was entitled to payment of certain postmasters' accounts in the insolvent national bank out of either (1) the general assets of the receivership, or (2) the surplus proceeds of the sale of United States bonds which had been pledged by the bank to secure its circulating notes. While the government's bill of complaint in the *Cook County National Bank* case prayed for an accounting and that a decree be entered directing the disposition of the funds belonging to the bank in the control of the Treasury Department, the action was in substance a bill to enforce an alleged right of set-off which was controlled and governed by the general law of set-off and this Court so treated it in discussing the general law of set-off on pages 452-3.

Circuit Judge Parker said in *Shannon* v. *Sutherland* (C. C. A. 4), 74 F. (2d) 530, 531; "The matter here involved is not one of procedure but of substantive right." The questions presented in the *Shannon* case involved set-off

as applied to insolvent national banks and in many respects the facts in that case are closely analogous to the facts involved in the instant case as will be discussed hereinafter at pages 37 to 39, inc.

The United States Circuit Court of Appeals for the Eighth Circuit likewise followed the doctrine that set-off as applied to insolvent national banks is a matter of substance in—

First National Bank of Indianola v. *Malone*, 76 F. (2d) 251, 254.

See also

Wisdom v. *Guess Dry Cleaning Company* (D. C. Miss.), 5 Fed. Supp. 762 at 763;

Bromley-Shepard Company, Inc., et al. v. *Roelker* (D. C. Mass.), 8 Fed. Supp. 214, at 215, affirmed, *Roelker* v. *Bromley Shepard Co. Inc., et al*, 73 F. (2d) 618, cert. den. 294 U. S. 713.

(While the *Bromley-Shepard* decision is cited for the particular point discussed above, that case is distinguished from the case at bar in other respects, *infra*, pages 33-34.)

That set-off as applied to insolvent national banks is a matter of substantive law governed by the general law of set-off is clearly settled by the above authorities as well as by *Scott* v. *Armstrong*, 146 U. S. 499, which will be discussed, *infra*, at pages 35-37.

(c) *Every Matter (Including Set-off) Relating to the Distribution of Assets of an Insolvent National Bank Presents a Question Arising Under the Winding Up Provisions of the National Bank Act.*

In the opening statement of respondents' brief in opposition to petition for writ of certiorari, it is said at page 1:

> "The respondents do not contend that Congress, if it chooses, may not provide by statute when set-off shall be allowed in liquidating a national bank. The

respondents' position is that Congress has not done so."

Apparently, the courts below in the instant case have agreed with the views of respondent on this question. We believe that the applicable principles and authorities which will now be discussed are directly to the contrary.

While it is true that there is no Federal Statute specifically dealing with the subject of set-off as applied to insolvent national banks, yet the winding up provisions of the National Bank Act (U. S. C. Title 12, Sections 91, 192 and 194, quoted in appendix at pages 42-43) requiring ratable distribution to all creditors alike contemplates that such dividends will be made "from what belongs to the bank, and that which at the time of the insolvency belongs of right to the debtor does not belong to the bank," as stated by Mr. Chief Justice Fuller in *Scott* v. *Armstrong, supra,* at page 510.

The real and ultimate question involved in this case is *what belongs to the bank and what belongs to the debtor.* It is the contention of petitioner as will be pointed out hereinafter, pages 17, 22, 23, that the assets of the partnership belong of right to the bank to the extent of the amount owing by the partnership to the bank and that such partnership assets do not belong of right to the partners.

A situation closely analogous to the instant case was presented to this Court in *Williams* v. *Heard,* 140 U. S. 529, wherein there was a dispute between the bankrupts and their assignee in bankruptcy as to whether or not a certain claim passed to the assignee. Mr. Justice Lamar in delivering the opinion of the court in the *Williams* case, said at page 536:

> "There is high authority in the state courts in support of the judgment of the court below. The same general question has arisen in New York, in Maryland, and in Maine; and in each instance the decision has been,

like the one we are reviewing, against the assignee. But as the question is one arising under the Bankruptcy Statute of the United States, we cannot rest our judgment upon these adjudications alone, however persuasive they may be."

Since petitioner as receiver has not only the right but also the duty to collect the partnership notes out of the partnership assets (as will be pointed out hereinafter, page 17), the allowance of the set-offs here under consideration would do violence to the express provisions of Section 5242 U. S. R. S., inasmuch as it would result in transferring to the respondents individually, (after the insolvency of the bank) partnership assets which are dedicated to the payment of the partnership indebtedness due and owing to the bank, to the prejudice of all other depositors and creditors of the receivership.

(d) *In Deciding Controversies Involving Set-off as Applied to Insolvent National Banks Federal Courts Will Not Follow the Varying Rules of State Courts (Applicable to Insolvents Generally) but Rather Will Exercise an Independent Judgment in Order That There May be Uniformity Throughout the Several States.*

Since set-off, in so far as it relates to insolvent national banks is a question of general law, the Federal courts will follow the rules of set-off as laid down by the Federal courts rather than the varying rules of set-off laid down by the several States as was done by this Court in deciding the controversy in *Gray* v. *Rollo*, 18 Wall. (85 U. S.) 629, at 632, wherein Mr. Justice Bradley expressly rejected the Pennsylvania rule of set-off with these words:

"In Pennsylvania, it is true, set-off is allowed in cases where the claims are not mutual, and, in that State, under the decisions there, it is probable that set-off would be allowed in such a case as this. But we do

not regard the rule adopted in Pennsylvania as in accord with the general rules of equity which govern cases of set-off. We think the general rule is stated by Justice Story, in his treatise on Equity Jurisprudence, (Section 1437), where he says:

'Courts of equity, following the law, will not allow a set-off of a joint debt against a separate debt, or conversely, of a separate debt against a joint debt; or to state the proposition more generally, they will not allow a set-off of debts accruing in different rights. But special circumstances may occur creating an equity, which will justify even such an interposition. * * *' "

and of necessity, this rule must be strictly enforced in determining rights of creditors and liabilities of the bank arising after insolvency of the bank as so aptly stated in *First National Bank* v. *Selden* (C. C. A. 7), 120 Fed. 212, 215:

"In such a case the federal trust must be administered according to the mandate of federal law. The moment the Niles bank went into the hands of the receiver, the federal law became the law of the distribution of its assets. In no other way could there be unity of administration, and a carrying out of the federal mandate of equality."

and by District Judge Elliott in *McCandless* v. *Dyar* (D. C. S. D.), 34 F. (2d) 989, 991:

"The simple question presented here is: Has this defendant the right of set-off under the circumstances pleaded in this action, brought by the receiver upon his indebtedness to the bank? In the determination of this issue we can have little concern for decisions of courts in controversies in the various states growing out of the insolvency of mercantile or other establishments or individuals, allowing a surety who, after insolvency and assignment for benefit of creditors, has paid the debt of his principal to offset such payment against his indebtedness to the principal whose affairs were being administered by the assignee or other officer. The right to the allowance of such an offset in the case at bar must

be determined in the light of the statutes of the United States controlling suspended national banks in the hands of a receiver appointed by the Comptroller of the Currency, and especially the provisions of the United States statutes prohibiting preferences in the liquidation of national banks."

To the same effect is *Fiman* v. *State of South Dakota* (C. C. A. 8), 29 F. (2d) 776, 777, cert. denied 279 U. S. 841.

See also *Thomas* v. *Potter Title and Trust Company* (D. C. Pa.), 2 Fed. Supp. 12, (approved in *Dakin* v. *Bayly*, 290 U. S. 143, 90 A. L. R., 999), wherein District Judge McVicar after quoting from *Gray* v. *Rollo, supra* (the same quotation found herein at page 13), stated at p. 13:

> "These rulings impliedly recognize that the United States courts exercise an independent judgment on matters of set-off and do not follow the decisions of State courts."

The enforcement of the respondents' right of participation in the distribution whether by way of set-off or otherwise must be determined by the Federal rule, cf.

Planters National Bank v. *Wysong and Miles Co., et al.*, 177 N. C. 380, 99 S. E. 199, 12 A. L. R. 1412 (citing *Barnett* v. *Muncie National Bank*, 98 U. S. 555), cert. den. 250 U. S. 665, and error dismissed, 251 U. S. 665.

(e) *Not Governed by the Conformity Act.*

The conformity act (Section 914 U. S. R. S., Title 28, U. S. C., Section 724) does not apply to this type of case, because

(1) This is a suit in equity and as such is expressly excluded from the provisions of that act.
Scott v. *Armstrong, supra,* at page 512.

(2) The question of set-off here involved is one of substance, not procedure, as has been discussed, *supra,* pages 8 to 10.

(3) A substantive right or defense arising under a Federal statute cannot be lessened or destroyed by a local rule of practice.

Norfolk Southern Railroad Company v. *Ferebee,* 238 U. S. 269.

(4) This section does not require a Federal court to follow State procedure, where to do so will defeat the purpose or impair the effect of any Congressional statute.

United States v. *Beaty* (D. C. Va.), 198 Fed. 284, reversed on other grounds, 203 Fed. 620; case certified to Supreme Court, 211 Fed. 1019; writ of error dismissed, 232 U. S. 463.

II.

Joint Primary Obligations of a Partnership Due to an Insolvent National Bank Cannot be Set Off Against the Individual Deposit Accounts of the Several Partners.

(a) *General Rules of Set-Off Stated.*

The rule of law in set-off requires mutuality of parties, *Beauregard* v. *Case,* 91 U. S. 134; mutuality of right, *Gray* v. *Rollo, supra,* and mutuality in quality of right, *Sawyer* v. *Hoag,* 17 Wall. 610; *Scammon v. Kimball, Assignee,* 92, U. S. 362; *Dakin* v. *Bayly, supra.*

It is the well settled Federal rule *applicable both at law and in equity* that a joint debt cannot be set off against a separate claim or demand and that a separate claim or demand cannot be set off against a joint debt for the reason that the claims accrue or exist in different rights or capacities which fact defeats the mutuality required for the allowance of set-off. This well settled doctrine was clearly stated by way of *dictum* and analogy in *Drexel* v. *Berney,* 122 U. S. 241, at 253, 4, thusly:

"The rule regulating the right of set-off is the same both at law and in equity, and yet there are many

cases where set-offs not permissible at law may be enforced in equity. As was said by Mr. Justice Story in Greene *v.* Darling, 5 Mason, 201, 209: 'Now, the general rule in equity is, like that at law, that there can be no set-off of joint debts against separate debts, unless some new equity justify it. Such an equity may arise under circumstances of fraud; or where the party seeking relief is only a surety for a debt really separate; or where there are a series of transactions in which joint credit is given with reference to the separate debt.' And at page 212: 'Since the statutes of set-off of mutual debts and credits, courts of equity have generally followed the course adopted in the construction of the statutes by courts of law; and have applied the doctrine to equitable debts; they have rarely, if ever, broken in upon the decisions at law, unless some other equity intervened which justified them in granting relief beyond the rules of law, such as has been already alluded to.'''

We shall now show that mutuality is lacking in several respects between the debt of the partnership to the bank on the one hand and the demands of the individual members of the partnership against the bank on the other hand, and then demonstrate that there are no equities in favor of respondents which justify the relief sought by them.

(b) *The Debt of the Partnership to the Bank and the Individual Deposit Accounts of the Respondents are lacking in Mutuality, Therefore are not Subject to Set-off.*

The promissory notes evidencing the indebtedness of the firm to the bank (R. 5, 6) by their express terms constituted joint obligations (as distinguished from several or joint and several), *Groves* v. *Sentell*, 153 U.S. 465. Furthermore, the joint character of the indebtedness is fixed by Title 59, Purdon's Pa. Stat. Ann., Section 37 (Section 15 of the Uniform Partnership Act) which reads in part as follows:

"Nature of partner's liability.—All partners are liable • • • (b) Jointly, for all other debts and obligations of the partnership; but any partner may enter into a separate obligation to perform a partnership contract."

The bill of complaint in this case discloses on its face that Benjamin Swinger, one of the members of the firm, died on February 28, 1933, and that the bank did not suspend operations until March 1, 1933. It is clear, therefore, that dissolution of the partnership took place as a matter of law (common law as well as statutory) immediately upon the death of Mr. Swinger.

Froess v. *Froess* 284 Pa. 369, 131 Atl. 276.

Upon dissolution, the partnership assets must be distributed in the manner provided by Title 59, Purdon's Pa. Stat. Ann., Section 102 (Section 40 of the Uniform Partnership Act), quoted in part in appendix pages 43, 44, *i. e.*, the partnership assets must be distributed first to partnership creditors before any distribution is made to the partners. Therefore, on February 28, 1933, when the firm having become dissolved as a matter of law, the partnership assets should have been used to pay the debt of the partnership to the bank. The interest of each partner in and to such partnership assets was subordinate to the interest, rights and equities of the creditors of the partnership.

Stated in another way, the partnership assets constitute a trust fund for the benefit of the firm creditors (including the Commercial National Bank of Philadelphia), *Murrill* v. *Neill*, 8 How. 414, 427 (citing Story on Partnership, p. 376).

The deposit accounts of the respondents as individuals are clearly and indisputably separate demands against the insolvent bank. We therefore have joint obligations of the partnership on the one hand and separate demands of the respondents as individuals on the other hand which cannot

be set off under the general rule requiring mutuality (see discussion *supra*, pages 15, 16). Furthermore, to permit the set-off would violate the requirement of mutuality indicated by *Cook County National Bank* v. *United States, supra; Thomas* v. *Potter Title and Trust Company, supra.* Petitioner is entitled to collect the partnership notes out of partnership assets rather than respondents being entitled to collect their deposit balances (indirectly) out of partnership assets.

Conceding for the purposes of discussion (but without admitting) that petitioner could have sued or can now maintain a suit against and recover from each or both of the respondents individually on the partnership notes, the required mutuality would not thus be established because the right to sue or the liability to be sued does not in and of itself create the right of set-off. The doctrine just stated was applied by this Court in *Dakin* v. *Bayly, supra,* wherein the Clearwater bank was denied the right to set-off demands held by it as agent against its debt to the receiver of the St. Petersburg bank even though the Clearwater bank could have brought suit against the St. Petersburg bank on the collection items. See also *Southern Railway Co.* v. *Elliott et al.,* (C. C. A. 4), 86 F. (2d) 294, wherein the railway company was denied the right to set off its deposit account against its liability on certain invoices which were pledged to secure the indebtedness of the lumber company to the insolvent bank. The receivers of the bank could have sued the railway company and the railway company could have paid its indebtedness on the invoices, thereby discharging the debt of the lumber company, nevertheless the set-off was denied.

(c) *Equity Will Not Permit Set-Off of Non-Mutual Debts Unless There Are Equitable Grounds Other Than Insolvency.*

It is settled law that insolvency is a recognized ground for equitable interference to the extent of inquiring into the

facts, looking to the substance, not the form, and to decide what, in each instance, is equitable and just with due regard to all parties in interest including the interests of third persons.

Gray v. *School District*, 67 F. (2d) 141, cert. den. *Hustead* v. *School District*, 291 U. S. 660;
Sawyer v. *Hoag*, *supra*.

In order that petitioner's contention may be made clear, it is freely admitted that death or insolvency of either party will not defeat the right of set-off where mutuality exists, *Yardley* v. *Clothier* (C. C. A. 3), 51 Fed. 506, 507; 17 L. R. A. 462; *Scott* v. *Armstrong*, *supra*. There is, however, a vast difference between insolvency defeating the right of set-off on the one hand and insolvency creating a right to set-off non-mutual demands on the other hand.

The court below (District) recognized that *insolvency* of a bank is *only one factor* to be considered in a situation of this kind (R. 10) but chose to follow the Pennsylvania rule which, it is said, grants set-off of non-mutual claims as a matter of right upon the insolvency of the payee, without the showing of any other equitable ground.

Federal courts of equity, upon inquiry into the facts, have allowed set-off (where there were substantial superior equities favoring the parties claiming the right to set-off) in the following types of cases:

(a) In favor of the surety where the principal debtor is insolvent. *Fidelity and Deposit Company* v. *Duke* (C. C. A. 9), 293 Fed. 661.

(b) In favor of the real debtor whether his or its name appears on the face or the back of the note and regardless of the provisions of the N. I. L. *Scott* v. *Armstrong*, *supra*. *Barrington* v. *Maner*, 54 F. (2d) 917. See also *Building and Engineering Company* v. *Northern Bank* (N. Y.), 99 N. E. 1044. Compare: *Knaffle* v. *Knoxville Banking & Trust Co.* (Tenn.), 159 S. W. 838, 50 L. R. A. (N. S.) 167.

(c) To the real owner of the claim. *Gray* v. *School District, supra.*

(d) To the party who will ultimately be required to pay the indebtedness. *Shannon* v. *Sutherland, supra; Scott* v. *Armstrong, supra.*

(e) Where the doctrine of mutual credits applies. *Roelker* v. *Bromley Shepard Company, supra; Scott* v. *Armstrong, supra.*

(f) Several debt (not joint) against several demand, *Beauregard* v. *Case, supra; Obiter in Richmond* v. *Litteer* (C. C. A. 8), 1 F. (2d) 311, 312.

(g) Where there was an agreement either express or implied to set off. *Millett* v. *Omaha National Bank* (C. C. A. 8), 30 F. (2d) 665; *Bromfield* v. *Trinidad National Investment Company* (C. C. A. 10), 36 F. (2d) 646; *Scott* v. *Armstrong, supra.*

On the other hand we find no Federal decision where set-off was allowed of a joint partnership debt (the firm as well as the member being solvent) against separate deposits of the individual partners in an insolvent national bank, nor have we found any Federal decision permitting set-off of non-mutual demands on the ground of insolvency of the bank alone.

The dearth of judicial decisions on the question of the right of an individual partner to set-off his deposit claim against the joint debt of the partnership to a closed national bank suggests that the many claimants (in the innumerable similar situations which have arisen in the three-quarters of a century since the enactment of the National Bank Act) have concluded that the position of the Comptroller of the Currency denying such set-offs in such cases is correct.

A situation closely analogous to the case here presented arose in *Jewett* v. *Martinsville Milling Company,* 76 F. (2d) 153 (1935), wherein a corporation sought by bill in equity to set off its deposit against the note of its president,

Schnaiter, to an insolvent national bank. Schnaiter owned practically all of the stock in the corporation. The Circuit Court of Appeals for the Seventh Circuit reversed the court below by denying the set-off, despite the fact that the loan was admittedly procured by Schnaiter for the accommodation and benefit of his corporation and despite the fact that Schnaiter owned practically all of the stock in the corporation. The Court said at page 155:

> "Set-off is at times allowed where to deny it would entail inequity and hardship which its allowance would avert. But no such situation is here presented. The only inequity which might here suggest itself would be toward the other depositors of this broken bank in case its distributable assets were reduced by applying the milling company's deposit account in discharge of the presumably collectible Schnaiter note.
>
> This record does not in our judgment disclose any of those elements which would justify the set-off."

See also:

Wolcott v. *Pierre,* 100 Ind. App. 16, 188 N. E. 596, 597,

wherein set-off of a partnership account against the debt of one of its partners to an insolvent national bank was denied, and *where the court held that insolvency of the bank was not an equity justifying departure from the rule prohibiting set-off of a joint account against a single debt.*

While the following outline is to some extent a repetition of other material in this brief we deem it advisable to point out with particularity that there are no superior equities in favor of respondents, but on the contrary the equities of other depositors and creditors of the bank are greater in number as well as superior in quality to the equities of respondents.

This is not a controversy between the individual partners on the one hand and the bank on the other, but is in sub-

stance an action brought by the two individuals as creditors of the bank against the other depositors and creditors of the bank, *Texas and Pacific Railway Company* v. *Pottorff*, 291 U. S. 245; *Jewett* v. *Martinsville Milling Company*, *supra*. Therefore, the rights, not only of the bank but also of the other depositors and creditors must be taken into consideration. That the receiver represents the creditors of the bank is too well settled to admit any question or doubt, *Kennedy* v. *Gibson*, 8 Wall. 498; *Case* v. *Terrell*, 11 Wall. 199.

In many cases the receiver can institute suits or assert defenses which would not be available to the bank itself, *Texas and Pacific Railway Company* v. *Pottorff*, *supra*; *McCandless* v. *Furlaud*, 296 U. S. 140, rehearing denied, 296 U. S. 664.

The equities favorable to the other creditors and depositors of the bank are summarized as follows:

(a) Equity, *following the law*, will not permit set-off of separate demands against joint obligations, unless some other equity intervene which justifies granting relief beyond the rules of law, *Scott* v. *Armstrong*, *supra*.

(b) The partnership assets were dedicated to the payment of indebtedness of the firm to the bank, and this was particularly so after dissolution caused by the death of Mr. Swinger. See discussion, *supra*, page 17. The interest and equity of the individual partners in and to the partnership assets was subordinate and inferior to the equities and rights of depositors of the bank who were (in equity) the owners of the partnership notes.

(c) The executrix of the estate of Benjamin Swinger, deceased, if she were permitted to set off the deposit account of the estate ($1,546.48) against the firm indebtedness would indirectly realize 100% of the deposit balance belong-

ing to the estate, by succeeding to the equity and interest of the receivership (depositors and creditors of the bank as distinguished from the bank itself) in the assets of the firm.

(d) By permitting Binenstock to set off $12,968.88 of his deposit account to the extinguishment of the balance of the firm indebtedness (1) his equity and interest in the partnership assets would be increased at the expense of the other depositors and creditors of the bank; (2) the partnership would be permitted to pay its debt with money of another in violation of the rule stated in *Gray* v. *School District, supra,* at pages 142, 143; (3) Binenstock would become entitled to contribution from the estate of Benjamin Swinger, deceased, in violation of the rule laid down in *Shannon* v. *Sutherland, supra,* and implied in *Williams* v. *Thomas,* (D. C. Mich.), 6 Fed. Supp. 1011.

(e) Indirectly, both partners would obtain full payment of their deposit accounts (plus interest at the legal rate until the notes are collected in full) to the extent of the amounts set off, contrary to the express provisions of the National Bank Act (U. S. C., Title 12, Sections 91 and 194) requiring ratable distribution (and none other) to all depositors alike and prohibiting preference of one creditor over others after insolvency of the bank. Cf. *Hanover National Bank* v. *Suddath,* 215 U. S. 122.

(f) Applying the conclusions reached by Circuit Judge Alschuler in *Jewett* v. *Martinsville Milling Company, supra* (see quotation, *supra,* at page 21); and by way of paraphrase,

> Set-off is at times allowed where to deny it would entail inequity and hardship which its allowance would avert. But no such situation is here presented. The only inequity which might here suggest itself would be toward the other depositors of this broken bank in case

> its distributable assets were reduced by applying the individual deposit accounts of Binenstock and Swinger in discharge of the partnership and the Cammarota notes which are presumably collectible. This record does not disclose any of those elements which would justify the set-offs.

The only equity in favor of the respondents (referred to in their brief in opposition to petition for writ of certiorari, pages 4, 5), is the fact that the insolvency of the bank forecloses the possibility of receiving 100% payment of their separate deposit accounts. **That unfortunate condition, however, affects not only the respondents but all other depositors and creditors of the bank as well. Consequently, this equity in favor of the respondents is not superior, but rather is only equal, to the same equity in favor of all depositors of the bank. Between equal equities the law must prevail.**

The many equities in favor of the other depositors far outnumber the single equity favorable to the respondents (which is equal rather than superior to the equity of other depositors) as has been pointed out. When all equities are weighed, it is clear that the balance is *against* the set-off and that the equities of other depositors are greatly superior in quality to those of respondents. See 44 Y. L. J., 171 (criticising *Bryant Brothers* v. *Wilson,* 253 Ky. 578, 69 S. W. (2d) 1020, wherein the Kentucky court permitted set-off in a case similar to the instant suit), the author of the note concluding, at page 173, by saying:

> "Since it is commonly accepted that in order to claim equitable set-off the substantial justice in its favor must be superior to the equitable arguments in opposition, Waterman, Set-Off, Section 439, it would seem that even on equitable grounds the instant decision is questionable."

III.

The Endorsement Liability of the Partnership Cannot be Set Off Against the Individual Deposit Accounts of the Respondents.

No distinction is drawn, either by the respondents or by the courts below, between the primary obligation on the notes executed by the firm as maker, and the secondary liability of the firm as endorser on the Cammarota note. This distinction was called to the attention of both courts and in particular to the Circuit Court of Appeals in the Assignment of Errors (R. 16) and was discussed in the briefs filed in that court.

The mere fact that the Cammarota note was not paid at maturity (and incidentally this note matured after the bank closed), creates no presumption of insolvency of the maker.

Spurway v. *Weintraub*, 66 F. (2d) 69.

It is well settled that the endorser is not entitled to set-off unless the maker or the party primarily liable is insolvent and unable to pay.

Williams v. *Rose*, 218 Fed. 898;
Bryant v. *Williams* (D. C. N. C.), 16 F. (2d) 159.

To the same effect see:

Bank of United States v. *Braveman*, 259 N. Y. 65, 181 N. E. 50;
In re Garfunkel, 8 F. (2d) 790.

See also:

Knaffle v. *Knoxville Banking & Trust Company, supra* (cited with approval by Circuit Judge Parker in *Shannon* v. *Sutherland, supra*).

wherein the surety was denied set-off even though jointly and severally liable with the principal.

District Judge Raymond in his comparatively recent decision in

Williams v. *Thomas, supra.*

dismissed, for want of equity, the bill filed by one of seven endorsers on a note executed (as maker) by a corporation which became insolvent. The bill sought to compel the receiver of an insolvent national bank to set off as against the plaintiff's deposit, the amount necessary to discharge the note of the corporation. In denying the set off the court pointed out that

(1) the plaintiff was jointly (not severally nor jointly and severally) liable as endorser.

(2) the rule is well settled that joint debts may not be set off against separate demands.

(3) that plaintiff's right of contribution from other endorsers in case he pays the note would make him whole,

and inferred that

(4) Insolvency of the bank was not a sufficient equity to justify a departure from the strict rule of mutuality.

(5) Insolvency of the bank plus the insolvency of the maker were not sufficient equities to justify a departure from the strict rule of mutuality.

By the same reasoning, if it had been sought to have the firm's deposit account set off against its endorsement liability on the Cammarota note, such relief could not properly have been allowed because the firm could thus, by indirection, obtain 100% of its deposit, plus interest, from Cammarota; *a fortiori* the prayers of the complainants to set off their individual deposit accounts against the endorsement liability of the firm should be denied.

IV.

Authorities Cited by Courts Below and Respondents, Distinguished.

(a) *On Question of Whether Federal Court or State Court Rule Should be Followed.*

The first decision cited by the District Court for the proposition that the Pennsylvania rule should be followed in this case is—

Burgess v. *Seligman*, 107 U. S. 20,

which involved the construction of a Missouri statute fixing the liability of shareholders of corporations organized under the laws of that State and even in that case it was held that the Federal courts having independent jurisdiction coordinate with that of the State courts are bound to exercise their own judgment as to the meaning of State laws.

The next case cited by the lower court is—

Sim v. *Edenborn*, 242 U. S. 131,

wherein the plaintiff *relying upon the laws of New York* sought to rescind a contract for fraud and to recover payments made thereunder. Mr. Justice McReynolds in delivering the opinion of the Court said, at page 135:

> "This court has many times considered how far Federal tribunals, when undertaking to *enforce laws of the States*, should follow opinions of their courts. The authorities were reviewed, and rule announced in Burgess *v.* Seligman, 107 U. S. 20, 33, 34, 35, which declared that, as to doctrines of commercial law and general jurisprudence the former exercise their own judgment, 'But even in such cases, *for the sake of harmony and to avoid confusion, the Federal courts will lean towards an agreement of views with the State courts* if the question seems to them balanced with doubt.'" (Italics ours.)

The last case cited by the District Court and the only one cited by the Circuit Court of Appeals is—

Traimor Company v. *Ætna Casualty Company,* 290 U. S. 47,

which dealt with a question of damages recoverable on a building completion bond. The Federal court followed the State rule not only "for the sake of harmony and to avoid confusion" but also "because the Pennsylvania decisions—are clearly right."

Respondents contend (pages 15 to 25, inclusive, of their brief in opposition to petition for writ of certiorari) that Title 28 U. S. C., Sec. 725 (721 U. S. R. S., which was derived from the Act of September 24, 1789, c. 20, Sec. 34, 1 Stat. 92), which provides:

> "The laws of the several States, except where the Constitution, treaties, or statutes of the United States otherwise require or provide, shall be regarded as rules of decision in trials at common law, in the courts of the United States, in cases where they apply."

was too narrowly construed in *Swift* v. *Tyson,* 16 Pet. 1, and place considerable stress (p. 18 to 21 of their brief in opposition to petition for writ of certiorari) on the dissenting opinion in *Black and White Taxicab and Transfer Company* v. *Brown and Yellow Taxicab and Transfer Company,* 276 U. S. 518, wherein Mr. Justice Holmes suggested that the rule laid down in *Swift* v. *Tyson, supra,* be limited and not allowed to spread into new fields of common law.

There is nothing in either the majority or the minority opinion in the *Black and White Taxicab* case nor in any of the cases cited by the courts below which could possibly be construed to mean that the Federal courts are bound by the State rules in deciding a question involving the rights of creditors of an insolvent national banking association which rights are fixed by the National Bank Act.

The provisions of Section 721, U. S. R. S., have no bearing on nor application to the case at bar, because—

(1) That section relates in express terms only "to trials at common law" which phrase does not include suits in equity, *Kirby* v. *Lake Shore and Michigan Railroad*, 120 U. S. 130, 137; 138.

(2) The National Bank Act has spoken on the questions of set-off here involved and must be regarded as the rule of decision. See *Connecticut Mutual Life Insurance Company* v. *Schaffer*, 94 U. S. 457; *U. S.* v. *Rathbone*, Fed. Cas. No. 16,121.

It is significant to note that even in the above decisions relied upon by the respondents this court advanced as one of the reasons (if not the principal reason) for its conclusions, the desirability of harmony of rules within each State and the avoidance of confusion. The very antithesis of those reasons applies in the instant case, namely, the desirability of harmony and uniformity of rules throughout the several states and the avoidance of confusion in winding up the affairs of national banks. To hold that the Federal courts should follow the State rules in the questions here presented would *prevent harmony* and *create confusion* in the administration of affairs of insolvent national banking associations.

Let us assume an insolvent national bank in Indiana and another in Pennsylvania have among their assets large notes of a solvent partnership, and that each bank owes substantial deposit balances to the individual members of the partnership. To follow the rule applied by the courts below would mean that the individual partners would receive in exchange for their deposit balances in the Pennsylvania bank, partnership notes worth not only the amount due thereon at the date of suspension but also interest at the contract rate provided for in the notes up until the date of payment of such notes, while in Indiana the individual

partners (under the rule followed in that State, *Wolcott* v. *Pierre, supra,* would receive only their ratable share in dividends with all other depositors of the bank in that State. Such ratable dividends would be produced in part at least from the collection by the receiver (of the Indiana bank) of the partnership notes in cash with interest up to the date of collection by the receiver. A comparison of these unequal results demonstrates at a glance that the winding up provisions of the National Bank Act requiring ratable distribution (and none other) to all creditors, and prohibiting preference of one creditor over others, would be rendered impotent by permitting the varying state rules to govern and control question of set-off, which are, in substance, questions of distribution.

It is necessary that a uniform rule be adopted by the Federal courts not only for the reasons stated hereinbefore, but also because of the importance of establishing a precedent for the guidance of the Comptroller of the Currency in administering the affairs of insolvent national banks as was done by the Supreme Court of Georgia in its decision in the set-off case entitled *Powell* v. *Mobley,* 142 S. E. 678, at page 679, wherein that court said:

> "Owing to the importance of establishing a precedent for guidance of the administrative officers of the State banking department, it has been deemed best to decide the case upon general principles of law as set forth in the foregoing division, without reference to special agreements of the parties."

(b) *Set-Off Cases Cited by Court Below, Distinguished.*

TUCKER v. *OXLEY* (1809), 5 Cranch. 34,

was the first equitable set-off case to be decided by this Court and is one of the authorities cited by the court below (District) in the instant case.

In that case Thomas Moore and Henry Moore carried on a partnership until March, 1802, when the firm was dissolved. Thomas agreed to collect the balances due and pay the debts of the firm as far as the joint property would extend and thereafter he continued business on his own account until he became bankrupt during the following September when Oxley was appointed assignee. Prior to the dissolution of the Moore partnership it became indebted to John and James Tucker for $106.49. After the dissolution of the Moore partnership (which was known to the Tuckers), the Tuckers became indebted to Thomas Moore for $118.12. No credit was given by Moore to the Tuckers for the $106.49 due to the latter nor was such credit expressly agreed to. Moore testified, however, that he intended to give such a credit. Oxley brought suit to recover the balance due to Thomas Moore and the Tuckers pleaded set-off which was denied by the lower court.

Mr. Chief Justice Marshall delivered the opinion reversing the court below and allowing the set-off on these grounds: (1) That the partnership debt was recoverable from each member and his property, therefore provable in bankruptcy against the estate of Thomas Moore. (2) That it was fair to conclude that the Tuckers forebore enforcement of the sum due from the Moores in consideration of the dealings with Thomas Moore after dissolution of the Moore partnership.

The facts in *Tucker* v. *Oxley* differ from the facts in the case at bar in the following respects:

(a) The indebtedness of the Tuckers to the insolvent (Thomas Moore) was a joint and several indebtedness, whereas in the instant case the indebtedness of the partnership is a joint indebtedness.

(b) There were facts and circumstances (not present in this case) from which the court found an implied agreement

of set-off, thereby justifying the court in applying the mutual credit doctrine.

GRAY v. *ROLLO* (1873), 18 Wall., 629.

was the next equitable set-off case (involving an insolvent) decided by this Court.

The (District) court below said (R. 9) that "*Gray* v. *Rollo* involves a basically different situation," and (R. 11) that "there is no decision of the Supreme Court of the United States holding otherwise (*than the Pennsylvania rule*). On the contrary, the dictum in *Gray* v. *Rollo* is to the effect that it (*set-off*) would be (*allowable*)" (italics inserted), despite the statement of Mr. Justice Bradley in *Gray* v. *Rollo*, at page 632, that "—we do not regard the rule adopted in Pennsylvania as in accord with the general rules of equity which govern cases of set-off."

In that case Gray filed a bill against Rollo, assignee in bankruptcy of the Merchants Insurance Company of Chicago, to compel set-off. Gray and Gaylord (not partners) had given their two joint notes for $5,555 each which were acquired in due course of business by the insurance company. The insurance company became indebted to Gray and his brother as partners for $30,000 on fire losses. Gray contended that his share of the liability on the notes was one-half and he wanted that amount set off against the liability of the insurance company on its policies, alleging that his brother was agreeable to the set-off. The insurance company's demurrer was sustained by the lower court and affirmed by this Court.

Mr. Justice Bradley said that the claims were not mutual debts, even though Gray could have been sued separately on the notes, because the claim on the policy was one due to Gray Brothers, and that the mutual credit doctrine was not applicable because there was no connection between the claims and no reliance of one on the other. The Penn-

sylvania rule permitting non-mutual claims to be set off was rejected and this Court said that no principle of equity in England or in this country would allow the set-off. It was said that no rule of justice or equity requires that Gray Brothers shall be paid in preference to other creditors of the insurance company out of the specific assets represented by the notes of Gray and Gaylord.

The previous decision in *Tucker* v. *Oxley, supra,* was analyzed by Mr. Justice Bradley who stated by way of dictum that the rule in the *Tucker* case would be applicable in the *Gray* case if the insurance company were solvent, and owed Gray alone on the insurance policies and Gray being insolvent was indebted with Gaylord to the company. In that event the insurance company could set off its liability on the policy against the notes of Gaylord and Gray, assuming each of them to be severally liable for the whole debt. The hypothetical facts assumed by this Court in *Gray* v. *Rollo* for the purpose of analyzing and explaining the rule in the *Tucker* case differ greatly from the facts in the case at bar in these respects:

(a) Binenstock (also Swinger) is solvent.

(b) The bank is insolvent.

(c) Swinger and Binenstock are jointly liable, not severally liable.

(d) Swinger and Binenstock are partners and the partnership assets are dedicated to the payment of the firm debts, whereas there was no showing that Gaylord and Gray were partners but rather were merely joint and several makers.

ROELKER v. *BROMLEY-SHEPARD COMPANY, INC.*, 73 F. (2d) 618, Cert. den. 294 U. S. 713.

The decision of the Circuit Court of Appeals for the First Circuit in the *Bromley-Shepard* case was referred to by the District Court below as being a case similar to the

present one except for the fact that the joint obligor who claimed the set-off may have been an accommodation party to the note. The reported decision of the District Court in the *Bromley-Shepard* case discloses that the bill in equity was filed not only by Mrs. Shepard but also by the Bromley-Shepard Company rather than by Mrs. Shepard alone. The District Court overruled the receiver's motion to dismiss, but the Circuit Court of Appeals directed that the note be set off *not against* Mrs. Shepard's deposit but rather against the deposit account of the corporation which received the benefit of the proceeds of the note and which was the real debtor. The *Bromley-Shepard* case differs from the case at bar in another important respect, namely, that the note in the former case was merely a joint obligation of a corporation and an individual, whereas in the instant case the indebtedness is the joint obligation of a partnership. Furthermore, the doctrine of mutual credits laid down in *Scott* v. *Armstrong, supra,* applies in the *Bromley-Shepard* case, but that doctrine has no application in the base at bar.

V.

Other Set-Off Cases Discussed and Distinguished.

BEAUREGARD v. *CASE* (1875), 91 U. S. 134.

Two years after the decision in *Gray* v. *Rollo, supra,* this Court rendered its first decision on a question of set off involving a national bank in *Beauregard* v. *Case, supra.* The facts in the *Beauregard* case differ from those here presented in that under the laws of Louisiana, where that case arose, the liability of Beauregard, May and Graham, as partners, to the bank was a distinctly several liability (not joint, nor joint and several), each partner being liable for a certain portion of the indebtedness of the firm equal to the extent of his interest in the partnership, whereas in the instant case the laws of Pennsylvania fixed the liability of

Swinger and Binenstock as joint (rather than several or joint and several). See discussions *supra*, pages 16 and 17.

Mr. Justice Field in delivering the opinion of this Court denying the set-off gave as one of the reasons for so doing (at page 141): "A partnership debt is not thus offset or compensated by a demand of one individual member against the creditor. There is no mutuality in such cases between the parties." It is difficult to conceive of any language more clearly expressing this fundamental rule upon which your petitioner has relied in originally denying the set-off and in defending this suit from its inception.

The above quotation is of particular significance in that it involved the question of whether or not an individual partner can set off his deposit account against the indebtedness of the partnership, whether solvent or insolvent, to an insolvent national bank.

SCOTT v. *ARMSTRONG* (1892), 146 U. S. 499.

Several questions were certified from the United States Circuit Court of Appeals for the Sixth Circuit in the case of *Scott* v. *Armstrong*. Only two of the questions so certified were answered by this Court. One of the questions answered involved a jurisdictional matter which is not pertinent to the issues presented in the case at bar. In answer to the other question certified this Court decided that the winding up provisions of the National Bank Act did not prohibit or prevent the set-off of a deposit account which was payable at the time of suspension of the bank, against the depositor's indebtedness to the bank even though such indebtedness was payable at a date subsequent to suspension.

As was pointed out in the opinion delivered by Mr. Chief Justice Fuller the set-off in the *Scott* case was proper because there was (1) mutuality of obligation; (2) mutuality of credit, and (3) an implied agreement for set-off (none of

which are present in the case at bar). The *general law* of set-off requiring mutuality was restated. The real question decided in the *Scott* case was that set-off was not defeated merely because the indebtedness of the depositor to the bank had not matured at the date of suspension. It is respectfully submitted, however, that the principle laid down in the *Scott* case fully supports the position and contention of petitioner in this case. Applying by way of paraphrase the doctrine enunciated by Mr. Chief Justice Fuller in the *Scott* v. *Armstrong* decision at page 510—it can be said:

> *The requirement of the National Bank Act (in so far as the collection of the partnership notes is concerned) as to ratable dividends, is to make them from the assets of the bank, which include a sufficient portion of the partnership assets to pay the partnership notes.*

and conversely,

> *The partnership assets which at the time of the insolvency of the bank belong of right to all of the depositors do not belong to the individual partners.*

Also may be noted the statement of Mr. Chief Justice Fuller—

> "Where a set-off is otherwise valid, it is not perceived how its allowance can be considered a preference * * *."

The clear implication from this language is that where a set-off is invalid such as the set-offs involved in the case at bar, it is not perceived how it can be validated by the winding up provisions of the National Bank Act which contemplate ratable distribution to all creditors alike with preferences to none.

The decision in the *Scott* case likewise supports petitioner's contention that set-off as applied to national banks is a matter of substance in that this Court discussed the matter from the viewpoint of the rights and equities of the

parties rather than from the viewpoint of its procedural aspects.

WISDOM v. *GUESS DRY CLEANING COMPANY*, 5 Fed. Supp. 762.

District Judge Holmes permitted set-off in the *Guess Dry Cleaning Company* case which involved the joint and several indebtedness of the partnership to an insolvent national bank rather than a joint indebtedness such as exists in the instant case. The court found as a fact that one of the partners in the *Guess* case was (insolvent) unable to make any substantial contribution toward the payment of the firm indebtedness, whereas in the case at bar there is no suggestion that either the firm or any of the partners is insolvent.

BARRINGTON v. *MANER* (C. C. A. 5), 54 F. (2d) 917.

The receiver of a national bank filed suit against Barrington (maker) and Horn (endorser). Barrington pleaded set-off of two partnership deposits owned on the date of suspension of the bank by the defendants. The interest of Horn in these accounts was assigned to Barrington after the bank closed but before the suit was filed. It was held that the notes were in reality the debt of the partnership and that set-off was proper. The court looked through the form, not only of the note but also of the pleadings, when it said, at page 918: "* * * the debts are not deprived of their mutuality merely by the circumstance that the suit was brought against the partners as individuals."

SHANNON v. *SUTHERLAND* (C. C. A. 4), 74 F. (2d) 530.

Shannon and five other persons borrowed a substantial sum from the bank to purchase a tract of land. The notes (which aggregated $9,450. when the bank closed) were

signed as trustees and were endorsed by each of the six persons interested in the purchase of the property. An agreement among them signed at the time of the execution of the original note, provided that upon failure of any one of them to pay his proportionate part of the liability the interest in the property to which he would otherwise be entitled should belong to the one or ones paying the amount of his liability. Two of the parties to the instrument became insolvent and paid nothing. Three of the others paid three-fourths of the amount due on the note, leaving a balance of $2,362.50 and interest. Shannon filed a bill in equity against the receiver of the bank seeking to set off the balance due on the note against a like portion of his deposit account which amounted to $2,657.83 at the time of the bank's failure. The District Court denied the set-off of any portion of the debt. The Circuit Court of Appeals reversed the District Court and permitted Shannon to set off one-sixth ($1,575.00) of the principal of the note which was due at the time the bank closed, being the extent to which he was primarily liable, and one-twelfth of the principal of the note representing that portion of his secondary liability for which he was not indemnified.

Circuit Judge Parker, in his well-reasoned opinion, stated at the outset that the matter there involved was one of substantive right and not of procedure. He further pointed out that if the entire principal of the note were set off against Shannon's account he would be partially indemnified by reason of his right of contribution from the other solvent obligors. In discussing the secondary liability of Shannon it was pointed out that he had indemnity to the extent of the interest he would acquire in the real estate by reason of the default of the two insolvent obligors. The situation in *Shannon* v. *Sutherland* is closely analogous to the situation here presented in these respects:

(a) Shannon was indemnified by reason of his right of contribution against other primary obligors as is each of the respondents here.

(b) In equity there is a secondary liability on the part of each of the respondents here in that the partnership debts should be collected first from the partnership assets before proceeding against the invidual partners.

(c) The case at bar is weaker from the viewpoint of respondents than was the Shannon case from the viewpoint of the plaintiff in that the partnership assets are dedicated to the payment of the notes involved in the instant case, whereas there were no assets pledged nor dedicated to the notes executed by Shannon and others.

An application of the rules laid down in *Shannon* v. *Sutherland* would justify only one result in the case at bar, namely, the denial of set-off to any extent because each of the respondents would be wholly indemnified. Application of the rules in the *Shannon* case would bar set-off of respondents' individual deposit accounts not only against the partnership notes but also against the Cammarota notes.

FIRST NATIONAL BANK OF INDIANOLA v. *MALONE* (C. C. A. 8), 76 F. (2d) 251.

The indebtedness involved in the *Malone* case was the joint and several obligation of husband and wife, not the joint obligation of partners. The deposit account carried in the name of the administrator of the estate of the deceased husband which the court permitted to be set off against the note, constituted a part of the assets of the estate which were dedicated in equity to the payment of the indebtedness of the decedent to the insolvent bank. In the case at bar the individual deposits of Swinger and Binen-

stock were not dedicated in equity or otherwise to the payment of the debts of the partnership.

The decision in the *Malone* case supports the contention of petitioner in this case in holding at page 254 that set-off is a matter of substance.

IN RE SCHULTS ET AL. (D. C. N. Y.), 132 Fed. 573.

In the above case District Judge Hazel denied set-off of the debt of Wilcox and son (a solvent partnership) due to a bankrupt banking firm (W. J. Schults and Company) against a claim due from the insolvent bankers to one of the Wilcox partners, and cited *Gray* v. *Rollo, supra,* as distinguishing *Tucker* v. *Oxley* by pointing out that the debt due from the Moores to the Tuckers was joint and several, consequently enforceable against either; whereas the debt of Wilcox and Company (like the debt of Swinger and Binenstock in this case) to the insolvent was a joint indebtedness. The facts in the *Schults* case are substantially identical with those here presented, the only difference being that the *Schults* case was one which arose in bankruptcy, whereas the instant case involves an insolvent national bank, but we submit, both cases are controlled by the same principles and rules of general law.

Conclusion.

It is believed that the foregoing discussion demonstrates that the propositions enunciated, as well as the results reached by the courts below, are in direct conflict with the applicable principles controlling decisions of Federal courts on questions of general law involving set-off as applied to insolvent national banks. If the rulings made by the lower courts are permitted to stand, serious and far reaching effects will be produced, confusion will be created in the administration of affairs of closed national banks, and set-off would be available solely on the ground of insolvency of

the bank, even though mutuality is lacking in many respects and despite the fact that the equities favor (both in number and in quality) the other depositors and creditors of the insolvent association.

It is therefore respectfully submitted that the decision below should be reversed and remanded with directions to dismiss the respondents' bill of complaint with prejudice.

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APPENDIX.

Statutes Involved.

U. S. C. Title 12, Section 91 (Sec. 5242 U. S. R. S.) provides:

> "*Transfers by bank and other acts in contemplation of insolvency.*—All transfers of the notes, bonds, bills of exchange, or other evidences of debt owing to any national banking association, or of deposits to its credit; all assignments of mortgages, sureties on real estate, or of judgments or decrees in its favor; all deposits of money, bullion, or other valuable thing for its use, or for the use of any of its shareholders or creditors; and all payments of money to either, made after the commission of an act of insolvency, or in contemplation thereof, made with a view to prevent the application of its assets in the manner prescribed by this chapter, or with a view to the preference of one creditor to another, except in payment of its circulating notes, shall be utterly null and void; and no attachment, injunction or execution, shall be issued against such association or its property before final judgment in any suit, action, or proceeding, in any State, county, or municipal court."

U. S. C. Title 12, Section 192 (Section 5234 U. S. R. S.) provides in part:

> "Such receiver, under the direction of the comptroller, shall take possession of the books, records, and assets of every description of such association, collect all debts, dues, and claims belonging to it, and, upon the order of a court of record of competent jurisdiction, may sell or compound all bad or doubtful debts, and, on a like order, may sell all the real and personal property of such association, on such terms as the court shall direct; and may, if necessary to pay the debts of such association, enforce the individual liability of the stockholders. Such receiver shall pay over all money so made to the Treasurer of the United States, subject to the order of the comptroller, and also make report to the comptroller of all his acts and proceedings."

U. S. C. Title 12, Section 194 (Sec. 5236 U. S. R. S.) provides:

> "*Dividends on adjusted claims; distribution of assets.*—From time to time, after full provision has been first made for refunding to the United States any deficiency in redeeming the notes of such association, the Comptroller shall make a ratable dividend of the money so paid over to him by such receiver on all such claims as may have been proved to his satisfaction or adjudicated in a court of competent jurisdiction, and, as the proceeds of the assets of such association are paid over to him, shall make further dividends on all claims previously proved or adjudicated; and the remainder of the proceeds, if any, shall be paid over to the shareholders of such association, or their legal representatives, in proportion to the stock by them respectively held."

Purdon's Pa. Stat. Ann., Title 59, Sec. 102 (Uniform Partnership Act, Sec. 40) provides in part:

> "*Rules for distribution.*—In settling accounts between the partners after dissolution, the following rules shall be observed, subject to any agreement to the contrary:
>
> (a) The assets of the partnership are—
>
> I. The partnership property,
>
> II. The contributions of the partners necessary for the payment of all the liabilities specified in clause (b) of this paragraph.
>
> (b) The liabilities of the partnership shall rank, in order of payment, as follows:
>
> I. Those owing to creditors other than partners,
>
> II. Those owing to partners other than for capital and profits,
>
> III. Those owing to partners in respect of capital,
>
> IV. Those owing to partners in respect of profits.

Other Statutes Cited and Discussed.

U. S. C. Title 28, Sec. 724 (914 U. S. R. S.) provides:

> "*Conformity to practice in State courts.*—The practice, pleadings and forms and modes of proceeding in civil causes, other than equity and admiralty causes, in the District courts, shall conform, as near as may be, to the practice, pleadings, and forms and modes of proceeding existing at the time in like causes in the courts of record of the State within which such district courts are held, any rule of court to the contrary notwithstanding."

U. S. C. Title 31, Sec. 191 (Sec. 3466 U. S. R. S.) provides:

> "*Priority established.*—Whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied; and the priority established shall extend as well to cases in which a debtor, not having sufficient property to pay all his debts, makes a voluntary assignment thereof, or in which the estate and effects of an absconding, concealed, or absent debtor are attached by process of law, as to cases in which an act of bankruptcy is committed."

INDEX.

Subject Index.

Page

1. There is no dispute in this case as to "Who may be a creditor and to what extent" 1
2. It is not clear that set-off would be available in this case even though the Pennsylvania rule were to be applied 2
3. Even if the partnership obligations are joint and several, set-off would not be proper in this case.. 5
4. Mutual credit doctrine relied upon by respondents not applicable here 8
5. Recent set-off decisions 9

CASES CITED.

Barrington v. Maner, 54 Fed. (2) 917..... 8
Building and Engineering Co. v. Northern Bank, (N. Y.) 99 N. E. 1044 8
Cochran v. Cutter, (1901), 18 Pa. Super. Ct. 282..... 3
Dickens v. Howard (C. C. A. 5), 67 Fed. (2) 263..... 6
Gordon, et al., v. Union Trust Company of Pennsylvania, 308 Pa. 493, 162 Atl. 293 2
Gray v. Rollo, 18 Wall. 629, 632 4
Hibert v. Lang, 165 Pa. 439 3
Hulse v. Knapp (D.C., W.D., N.Y.), 20 Fed. Supp. 137. 6, 9
Kardon v. Willing (D.C., E.D., Pa.), 20 Fed. Supp. 471.2, 10
McCandless v. Dyar (D.C., S.D.), 34 Fed. (2) 989.... 6
Miller v Reed, 27 Pa. 244 7
Mintz v. Tri-County Natural Gas Company, 259 Pa. 477, 103 Atl. 285 4
Scott v. Armstrong, 146 U. S. 499 8
Shannon v. Sutherland (C. C. A. 4), 74 Fed. (2) 530.. 8
Stewart v. Coulter (1825), 12 S. & R., 252 and 253..... 3
U. S. F. & G. Co. v. Wooldridge (C. C. A. 5), 295 Fed. 847, 849, affirmed 268 U. S. 234..... 6

MISCELLANEOUS CITATIONS.

Michie on Banks and Banking, Volume 5, page 276.... 9
3 R. C. L. 591 9
7 C. J. 659 ..... 9.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1937.

No. 36.

JOSEPH K. WILLING, Receiver of Commercial National Bank, Philadelphia, Pennsylvania, *Petitioner*,

v.

ISRAEL BINENSTOCK, Individually and as Surviving Partner of the Partnership Firm of Swinger and Binenstock, and BESSIE SWINGER, Individually and as Executrix of the Estate of Benjamin Swinger, Deceased, *Respondents*.

REPLY BRIEF OF PETITIONER.

Respondents' brief raises questions and advances arguments which petitioner deems advisable to discuss.

1. There is No Dispute in this Case as to "Who May be a Creditor and to What Extent."

Respondents state (page 4 of their brief) that the basic question here at issue is "who is a creditor and to what extent." Petitioner submits that the real or fundamental inquiry in this or any other set-off case involving an insol-

vent national bank is two fold, viz: (a) "who is the real debtor?" (on the partnership, as well as on the Cammarota notes) and (b) "whose money or claim is proposed to be used by way of set-off?"

This test was applied in the comparatively recent decision by District Judge Maris of the Eastern District of Pennsylvania in *Kardon* v. *Willing*, 20 Fed. Supp. 471, involving a factual situation quite similar to the one here presented. This test has even been applied by the Pennsylvania courts. See *Gordon, et al.*, v. *Union Trust Company of Pennsylvania*, 308 Pa. 493, 162 At. 293, wherein Mr. Justice Kephart said, inter alia—

> "The names in which suit could be brought and defended furnish an indication, but are not the only criterion, of the right of set-off. To whom do the funds really belong? Mutuality of right in a set-off is not circumscribed by the 'right to bring an action' but the broader question may be and generally is, of importance. Whose money or claim is proposed to be used as a set-off? This is the true equitable principle which governs such questions."

Further to the effect that the mere right to sue is not the real test as to the right of set-off, see petitioner's main brief, p. 18.

2. It is Not Clear that Set-off Would Be Available in this Case Even Though the Pennsylvania Rule Were to be Applied.

From pages 21 to 35, a considerable portion of respondents' brief undertakes to show that *under Pennsylvania decisions* set-off would be available in this case. Petitioner considers that it makes no difference whether the Pennsylvania rule on off-sets is in accord or in conflict with the Federal rule. Petitioner deems it advisable, however, to point out that his analysis of the Pennsylvania cases cited by the respondents leads petitioner to the conclusion that those decisions do not "clearly sustain the (respondents') bill," as stated by the District Judge below and by the respondents on page 21 of their brief.

It is important to note that in none of the cases cited by respondents was the creditor of the partnership a bank or an insolvent. Furthermore, all of the Pennsylvania cases cited by the respondents and by the courts below involved legal set-off as distinguished from equitable set-off which is here involved. As hereinafter indicated, these distinctions are important.

Mr. Justice Duncan stated his view in *Stewart* v. *Coulter* (1825), 12 S. & R., 252 and 253 (respondents' brief, pages 22, 23):

> "At the trial my opinion was, that the indebtedness of the plaintiff to one defendant, was of itself, *unless there was some superior equity in a third person* a subject of set-off by that defendant, although he had been sued with others, * * *." (Italics ours.)

There are many superior equities in the instant case in favor of third persons (general creditors of the subject insolvent bank) as pointed out and discussed in petitioner's main brief, pages 22-24.

The case of *Cochran* v. *Cutter,* (1901), 18 Pa. Super. Ct. 282, cited and discussed at page 24 of respondents' brief, involved a plea of set-off filed by defendant in an action of assumpsit, a law action. Presiding Judge Rice in the opening statement of his opinion in the Cochran case (page 283) quoted from the opinion of Mr. Justice Mitchell in *Hibert* v. *Lang,* 165 Pa. 439, wherein the last-named Justice reviewed the previous Pennsylvania decisions involving set-offs and said:

> "The result of these cases is that although in general in order to support a set-off there must be cross-demands between the same parties and in the same rights, such as would sustain mutual actions against each other, yet wherever there is the practicability of avoiding circuity of action and needless costs, with safety and convenience to all parties, *or where there is a special equity to be subserved, and no equity of third parties to be injured,* a set-off will be allowed upon equi-